



**WORLD BANK GROUP**

# **Indonesia Economic Quarterly March 2016**

***Private investment is essential***

***Ndjamé Diop***  
***Lead Economist, Indonesia***

**March 15, 2016**

# Introduction

## 2015: tough but growth expected to have bottomed out

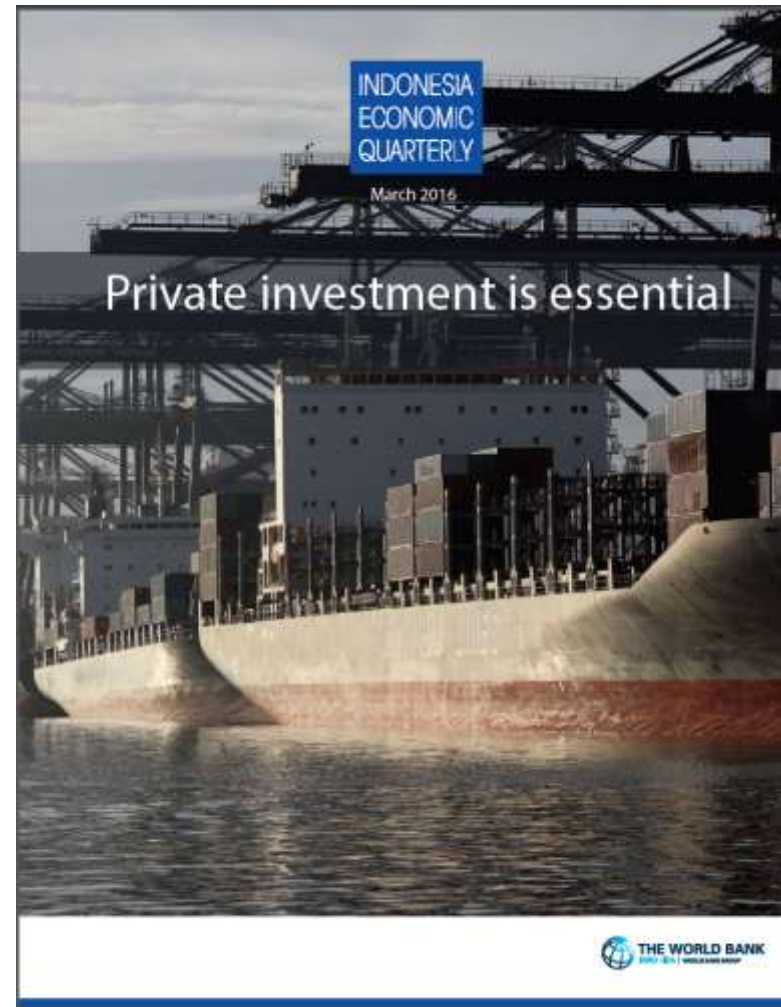
- Significant improvement in composition of spending away from energy subsidies...
- ... allowing a spectacular rise in public investment...
- ... and helped growth in 2015

## 2016: staging a firm rebound will be no small challenge

- Given pressures on export and oil and gas fiscal revenues, private investment recovery is essential

## Private investment also critical to address medium-term challenges

- Revival of manufacturing, rise of tourism
- Good quality jobs



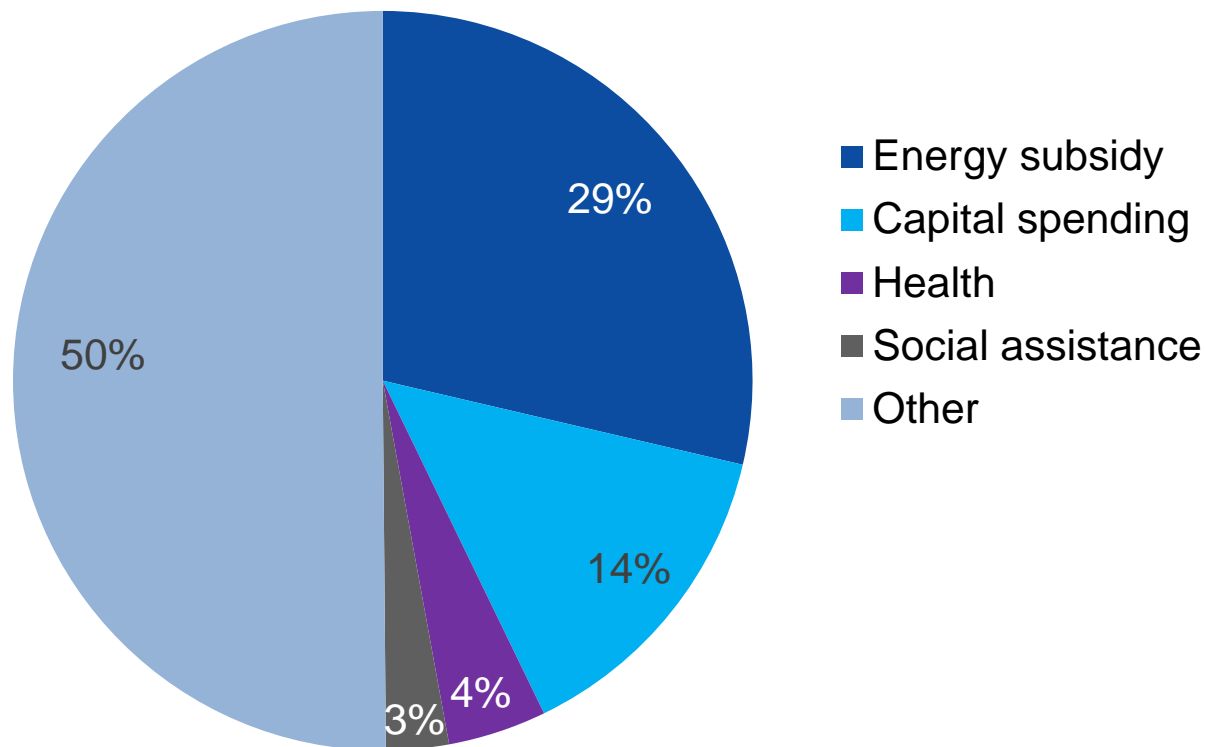
**How public investment helped growth**

**Staging a firm growth rebound in 2016**

**Medium-term challenges and opportunities**

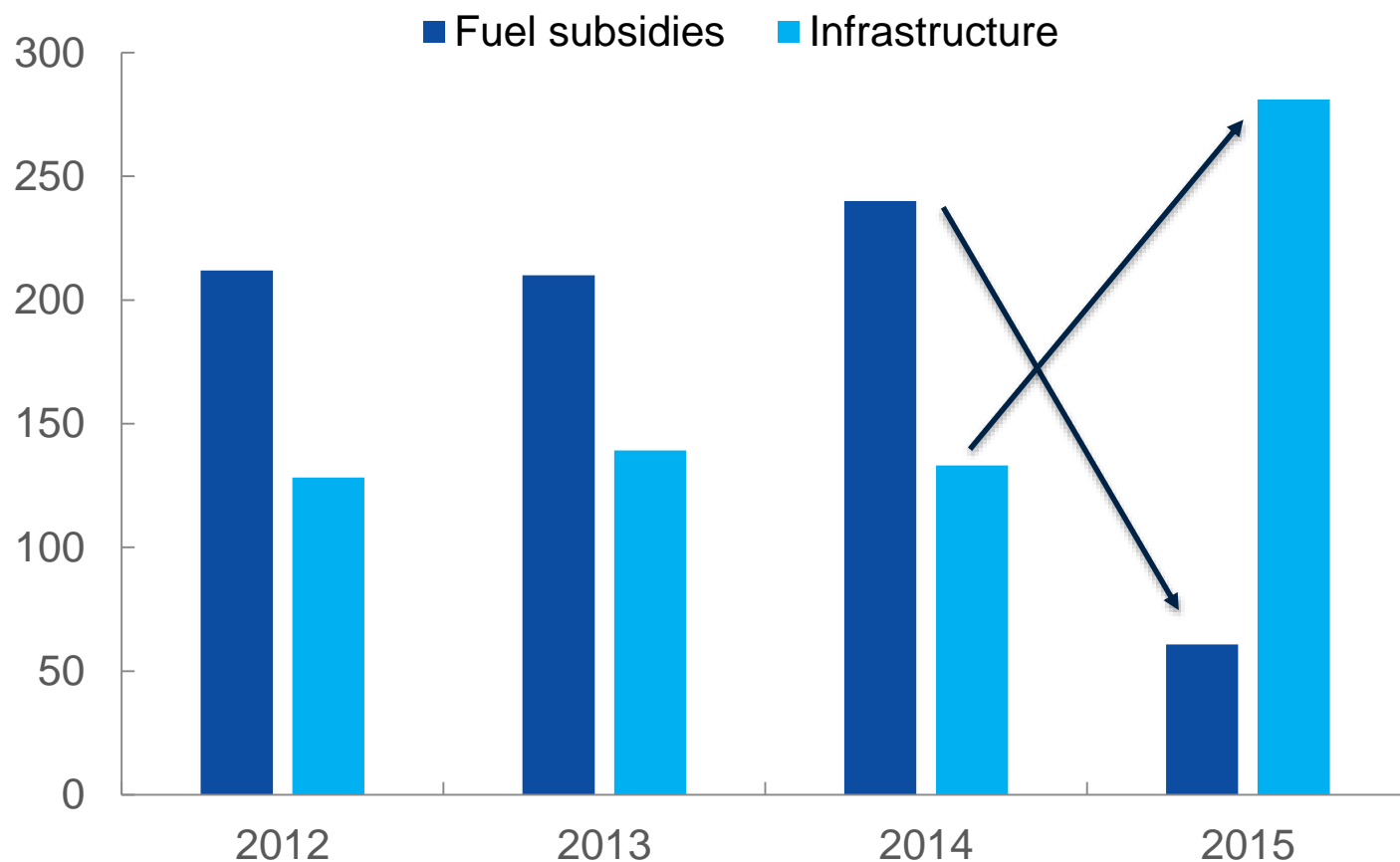
# The budget before 2015: *Close to 1/3 spent on energy subsidies*

*Share of average central government spending, 2012-2014, percent*



Source: Ministry of Finance; World Bank staff calculations

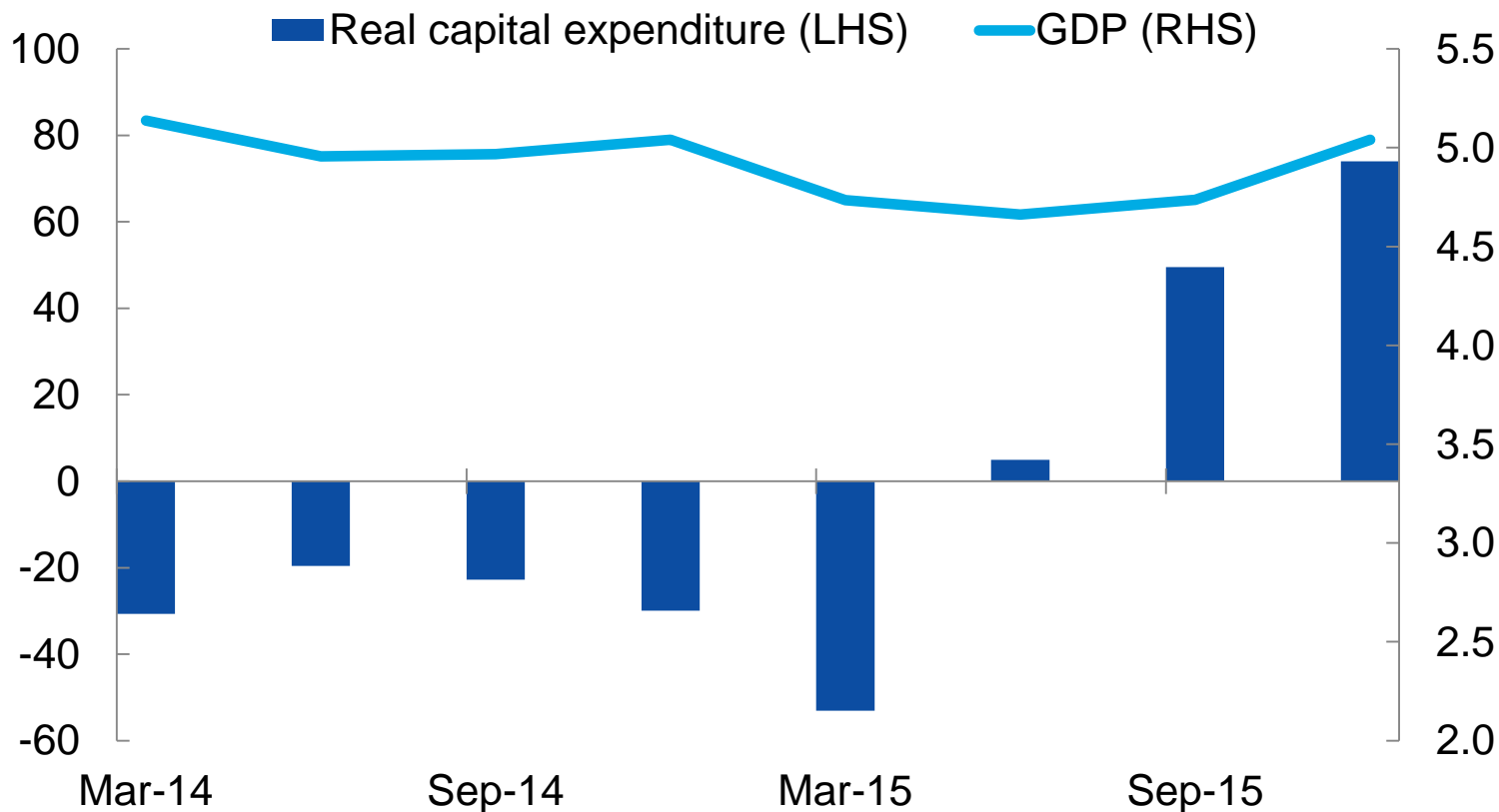
# Fuel subsidy reform: *The foundation*



Source: Ministry of Finance; World Bank staff calculations

# Public investment and growth in 2015

*Real growth yoy, percent*



Note: Capital expenditure deflated with the implicit fixed investment deflator.

Source: BPS; Ministry of Finance; World Bank staff calculations

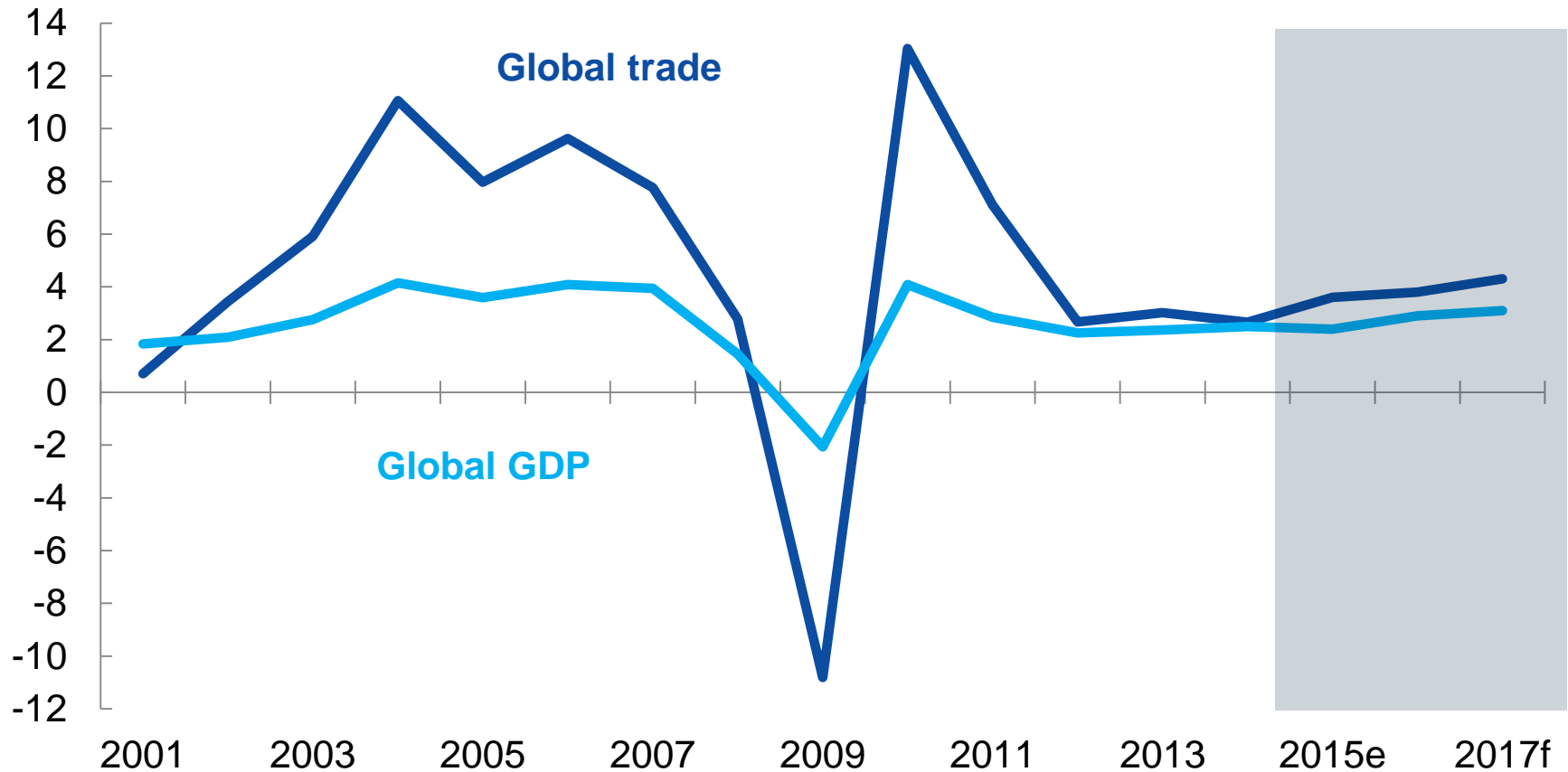
**How public investment helped growth**

**Staging a firm growth rebound in 2016**

**Medium-term challenges and opportunities**

# Weak global growth and global trade: *Harder to generate export revenues*

*Annual growth, percent*



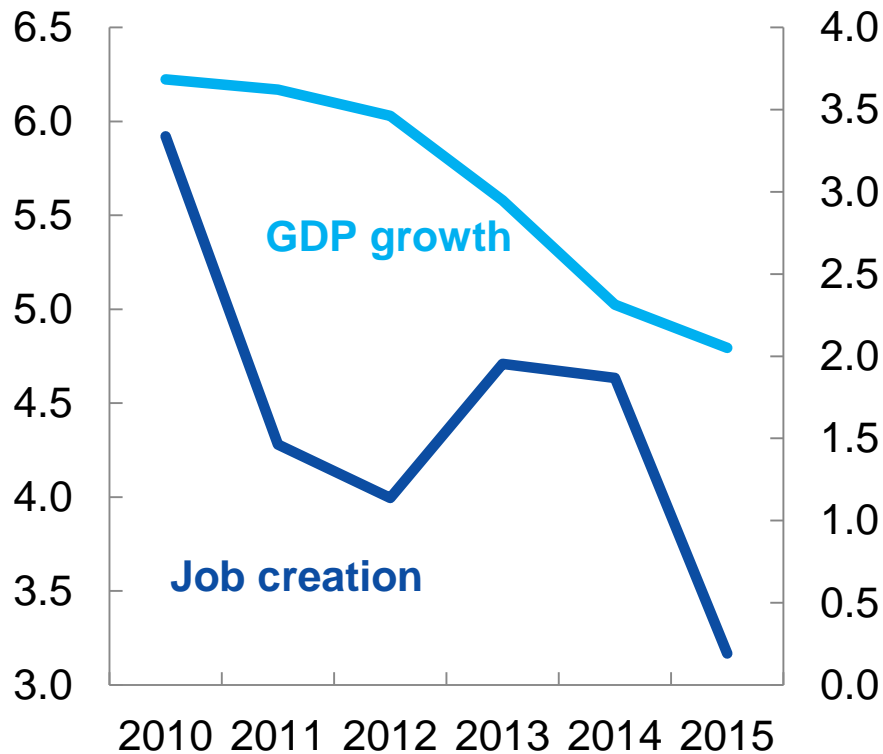
Source: World Bank, January 2016 Global Economic Prospects



# Subdued household real income growth

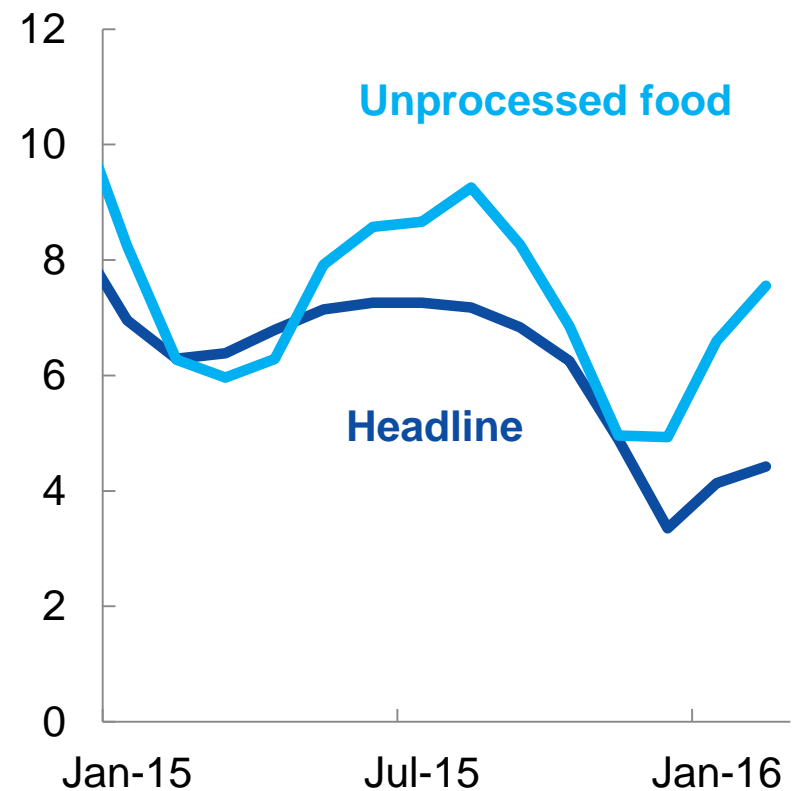
## *Only moderate pick up in private consumption*

**Weaker job creation**  
**GDP growth, percent, LHS; millions, RHS**



Source: BPS; World Bank staff calculations

**Persistently high food price inflation, percent**

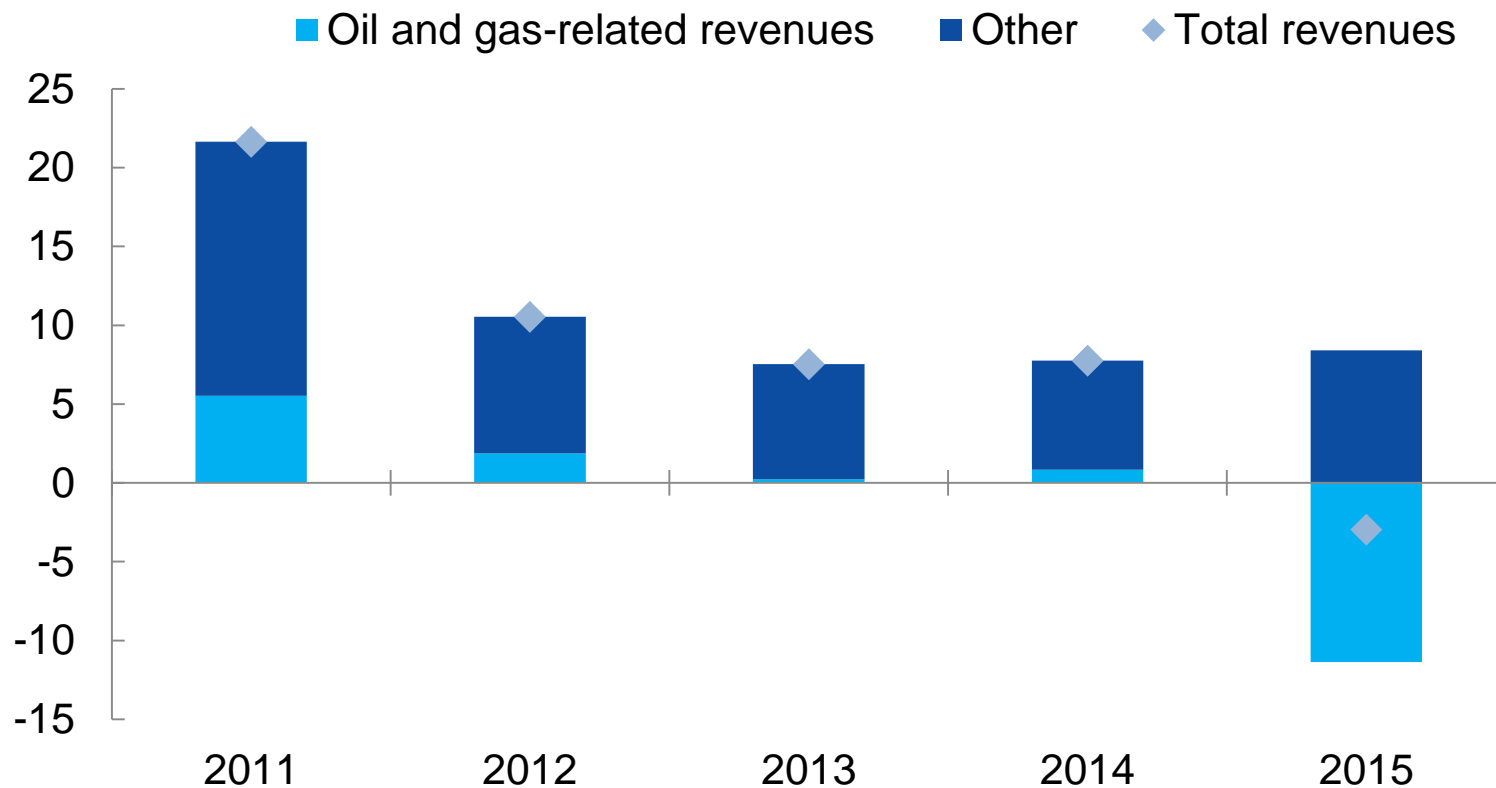


Source: BPS; World Bank staff calculations

# Low commodity prices

## *Continued pressure on oil and gas fiscal revenues*

**Contributions to nominal growth yoy, percent**

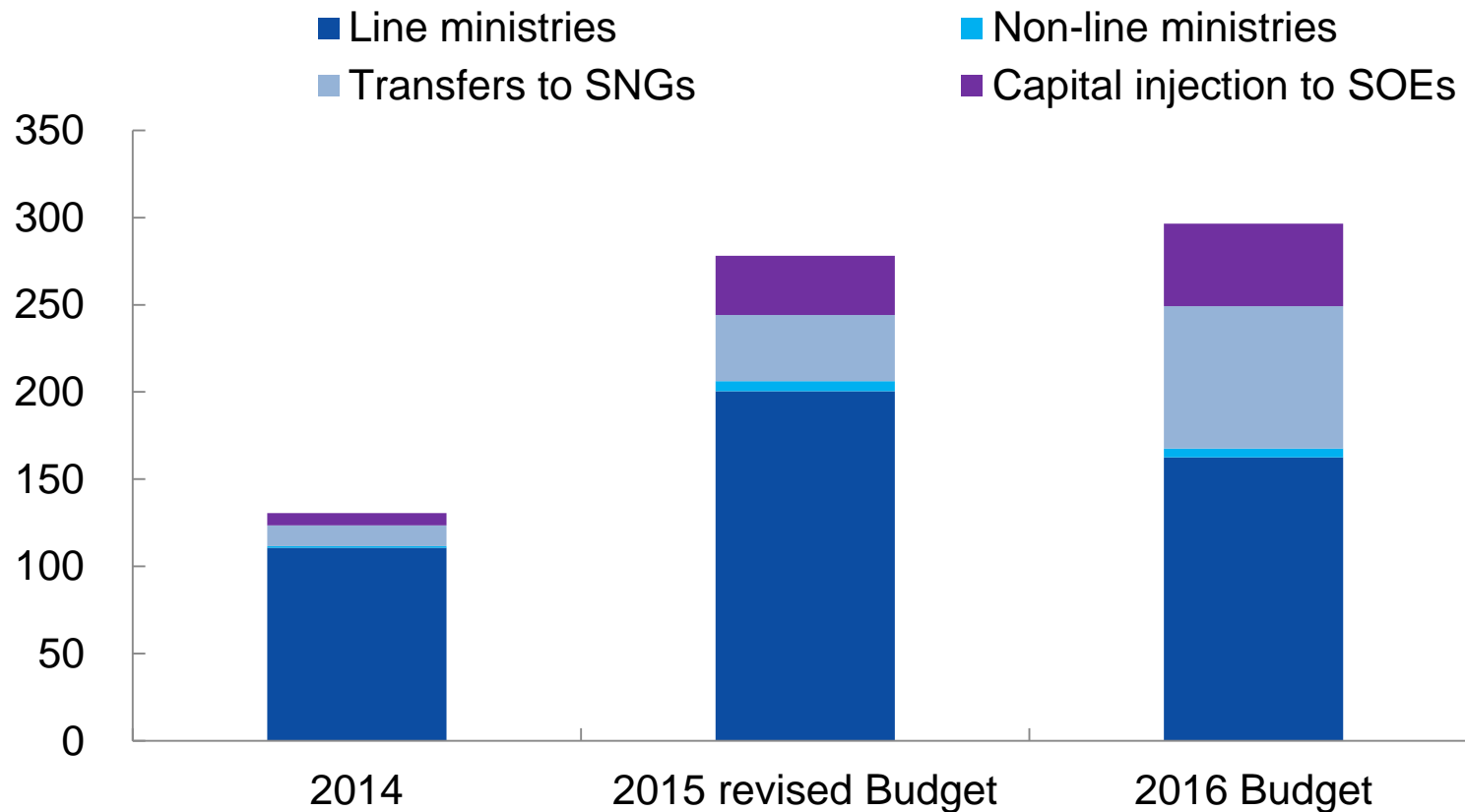


Source: Ministry of Finance; World Bank staff calculations

# Public investment rise in 2016

*Likely less dramatic than in 2015*

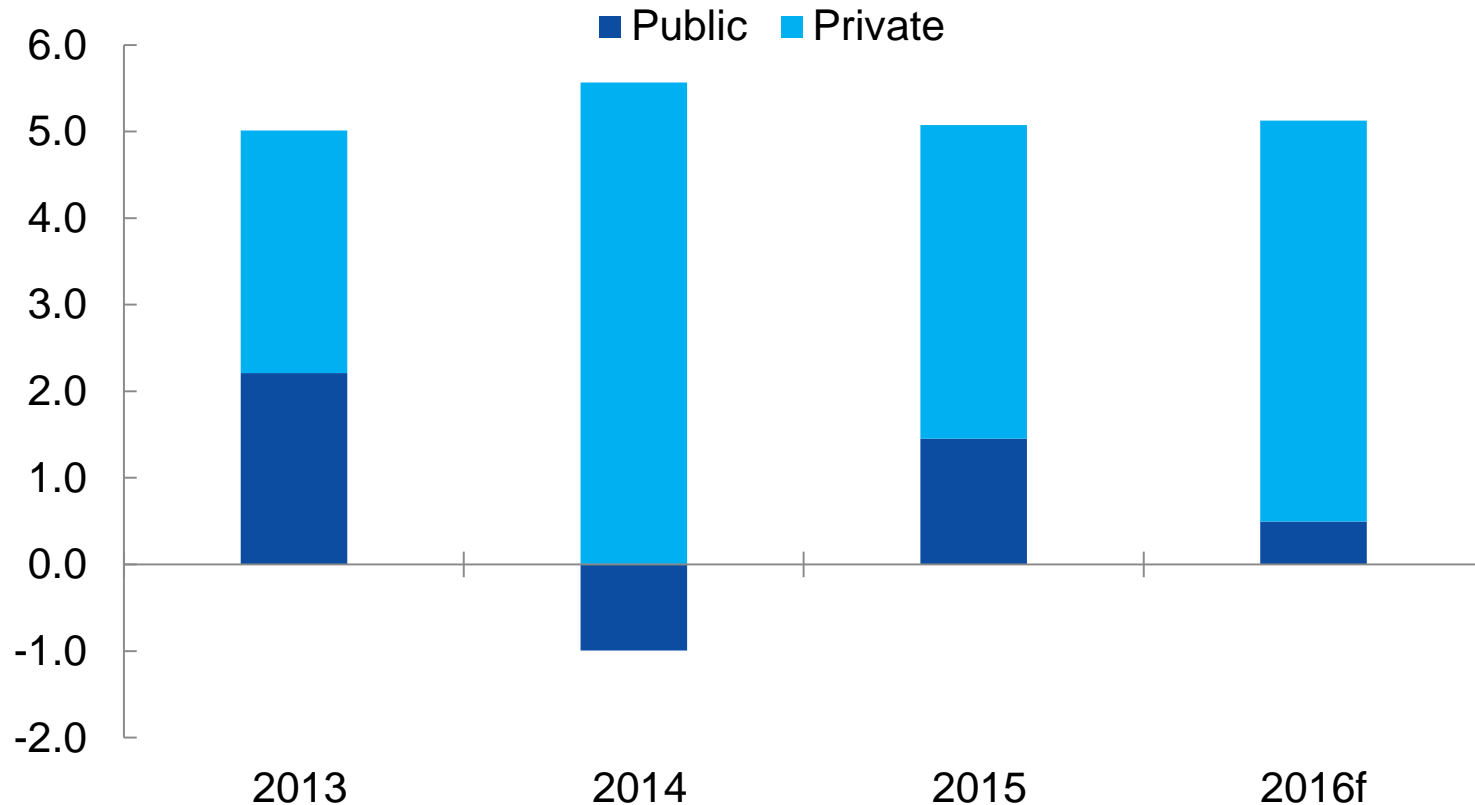
Budget allocation for infrastructure increases, driven by transfers to SNGs and SOEs  
(IDR trillion)



Source: Ministry of Finance; World Bank staff calculations

# Private investment is essential

Real fixed investment growth  
(percent yoy)



Note: Capital expenditure deflated with the implicit fixed investment deflator.  
Source: BPS; Ministry of Finance; World Bank staff calculations

# Baseline outlook

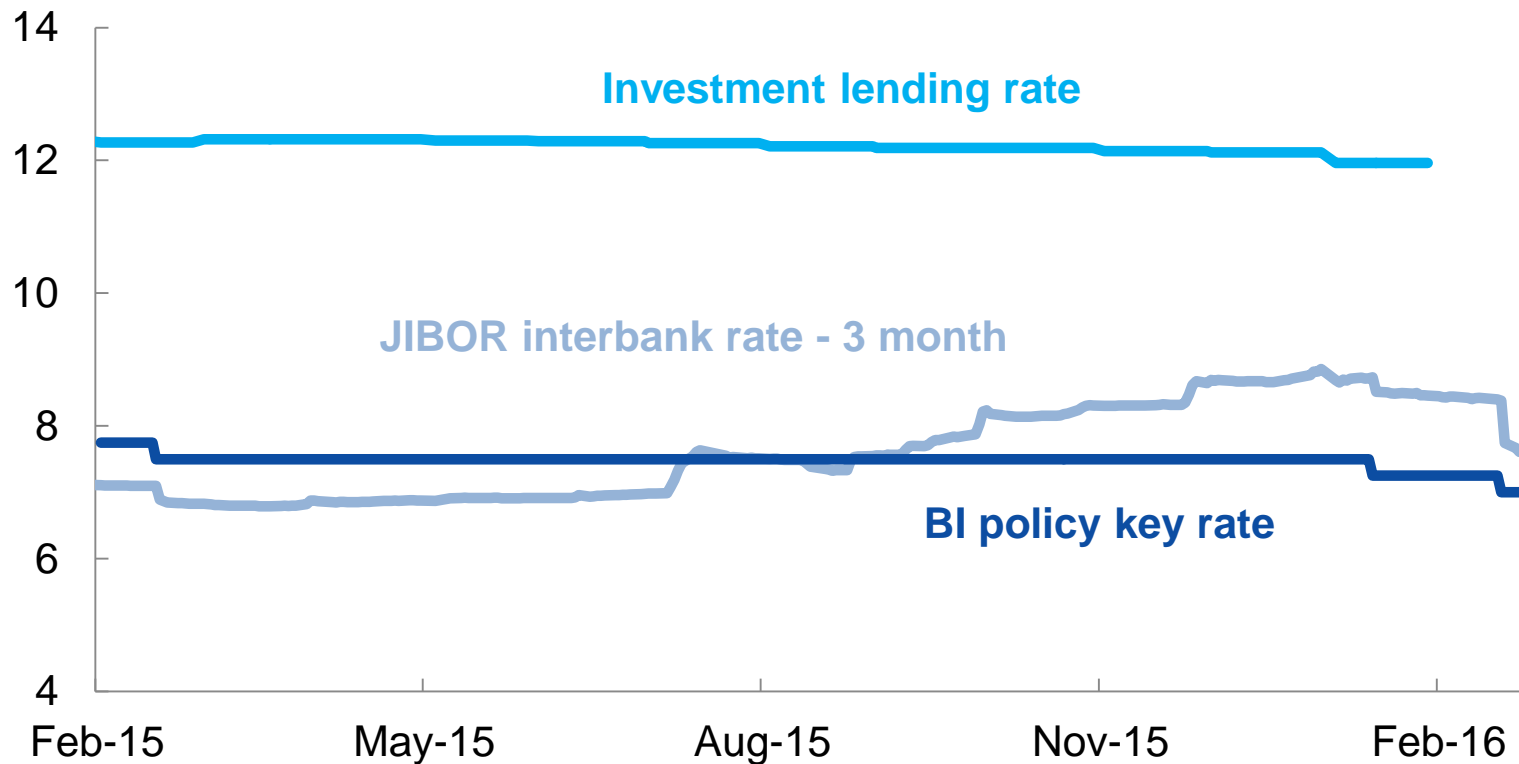
	2015	2016f	2017f
Real GDP (annual % change)	4.8	5.1	5.3
Consumer prices (annual % change)	6.4	4.0	4.6
Current account balance (% of GDP)	-2.1	-2.3	-2.5
Budget balance (% of GDP)	-2.5	-2.8	n.a.

Source: BPS; World Bank staff projections

# Supporting near-term growth (1)

## *Gradual monetary easing*

*Annual growth, percent*



Source: BI; World Bank staff calculations

# Revenue collection

## *Ongoing reform areas critical*

- **Reforming tax policy:**
  - Revisions to Income Tax and VAT Laws and the Final Tax regime for MSMEs provide an opportunity to broaden the tax base and reduce economic distortions.
- **Strengthening tax administration:**
  - Ease electronic filing process for taxpayers, while making e-filing mandatory for certain types of taxes;
  - Unique taxpayer ID system;
  - Improved compliance risk management and auditing processes, including use of third-party data;
  - Stronger law enforcement efforts.
- **Building the underlying tax administration capacity:**
  - Investment in IT and data management systems.

# Business environment

## *Further reforms could tip investor confidence*

- **Reducing or removing minimum capital and reserve requirements for setting up logistics service providers** – too high and hinder competition
- **Clarifying the roles of port authorities and port operators in port development and management** – lack of clarity has led to severe underinvestment in port infrastructure
- **Regulatory review mechanism is needed** to take stock of existing business, investment and trade regulations (e.g. NTMs), cancel ones that are conflicting and unnecessary, and reject or approve new regulations
- **Establishing an up-to-date, comprehensive depository of licensing/regulatory requirements that can be accessed online** - there is no list of requirements that firms needs to comply with



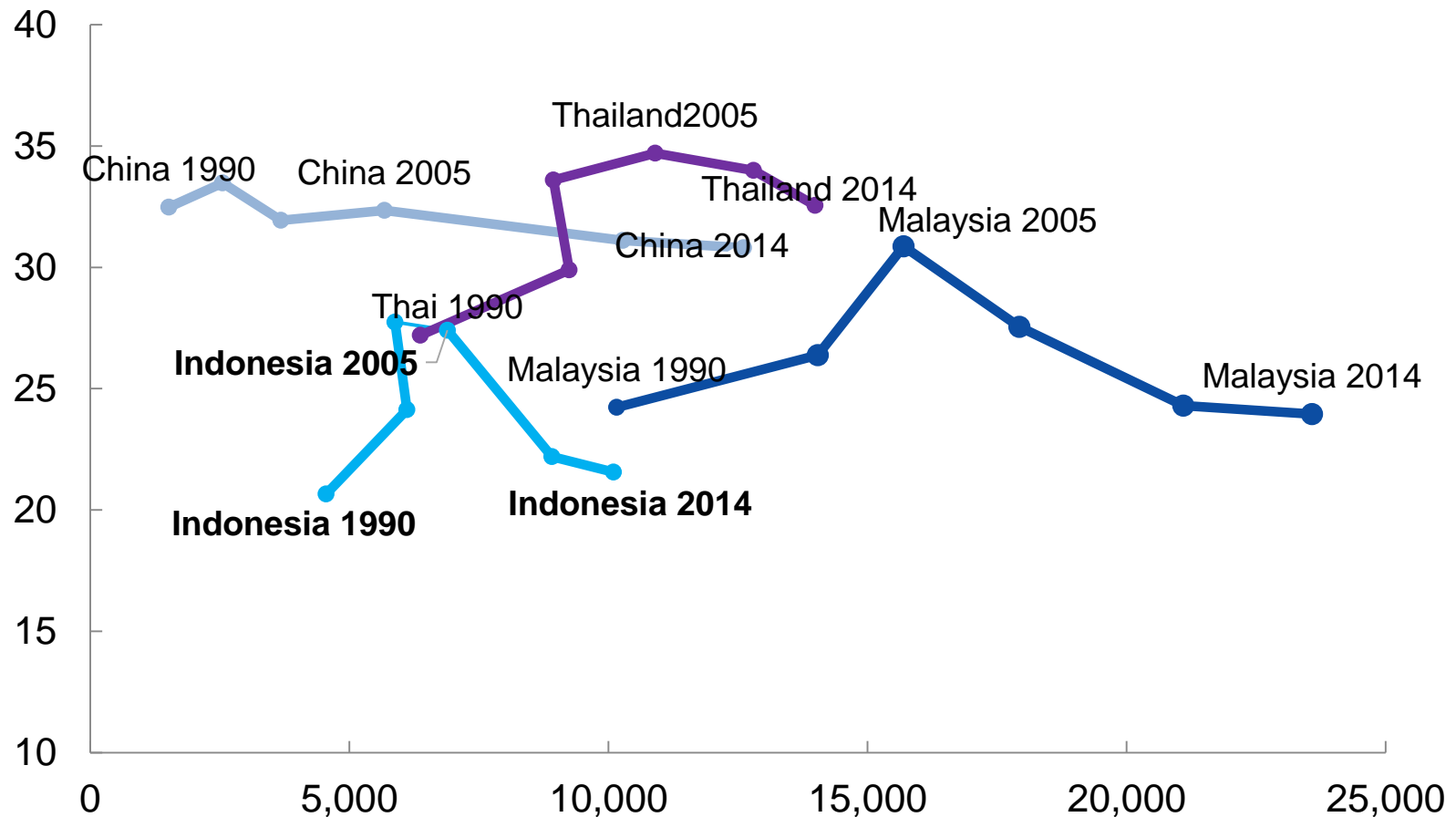
**How Public Investment Helped Growth**

**Staging a firm growth rebound in 2016**

**Medium-term challenges and opportunities**

# Manufacturing has prematurely retracted due to commodity boom

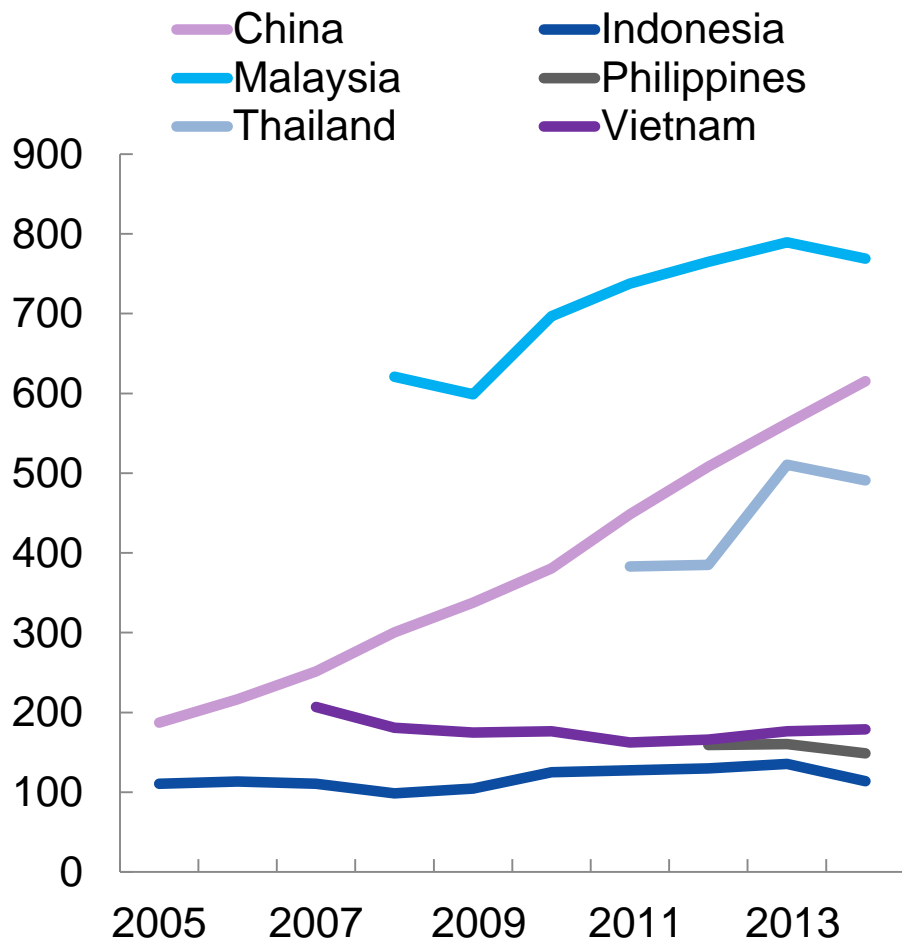
*Manufacturing as percentage of GDP (y axis), GDP per capita (x axis), PPP (constant 2011 int USD)*



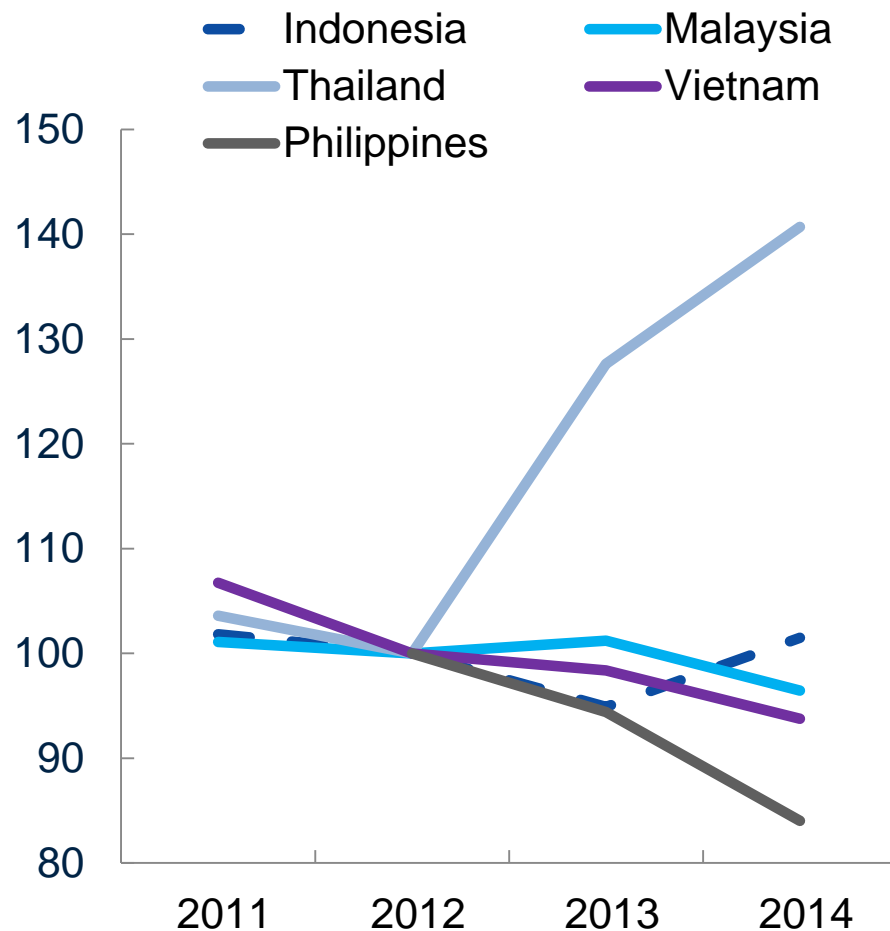
Source: World Development Indicators, World Bank

# Worker productivity is low despite wage advantage

*Real wages (real 2012 USD)*

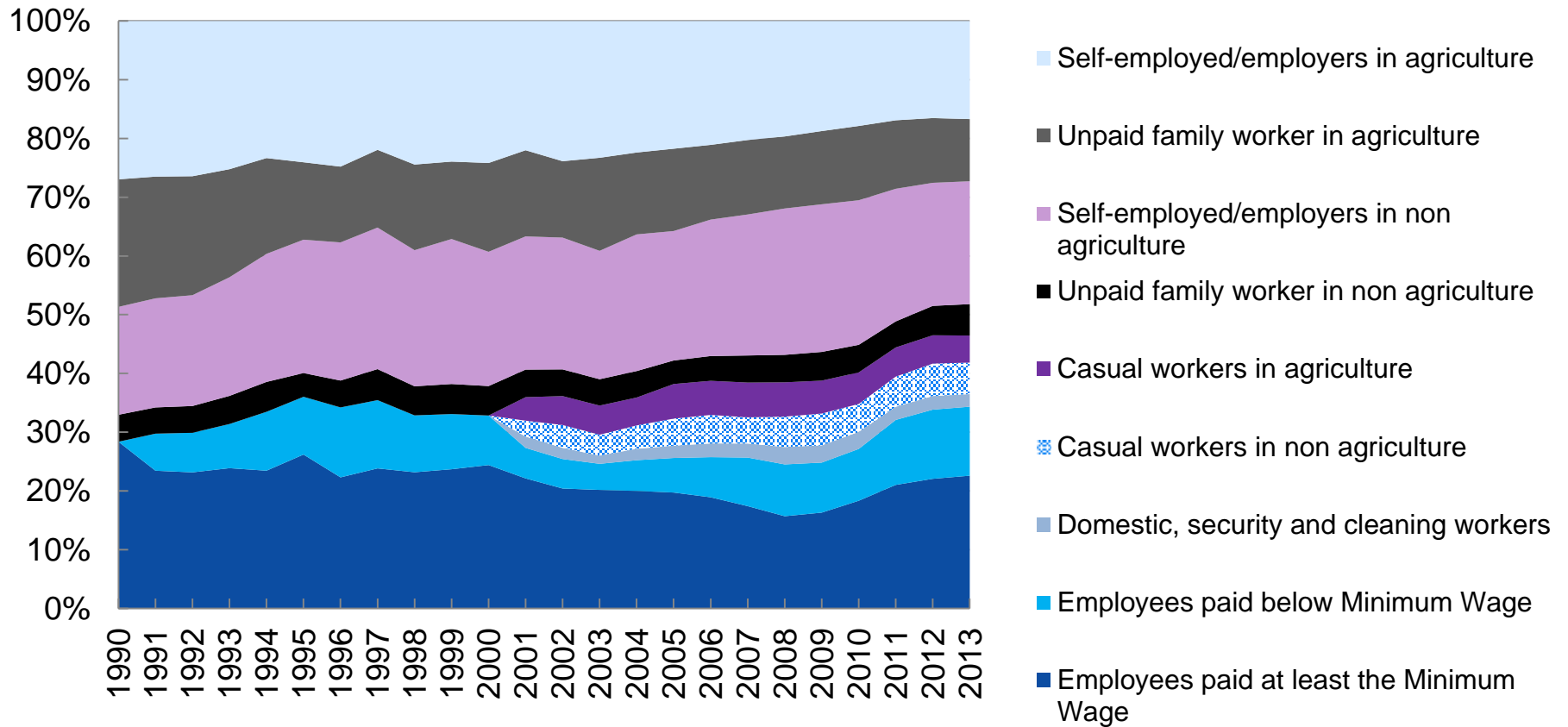


*Unit labor costs in manufacturing, 2012 =100*



# Sluggish manufacturing growth and low productivity have reduced the quality of jobs...

*Percent of workers in different types of work*



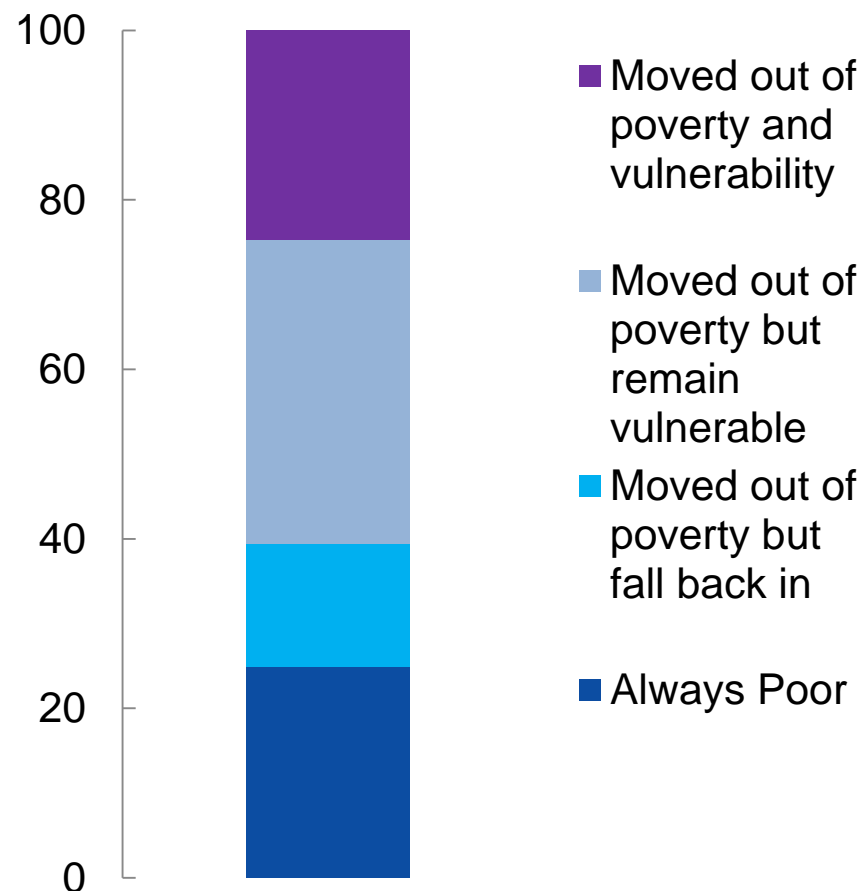
Source: World Bank calculations based on BPS, Sakernas data

# ...and kept many people vulnerable

## *Poor quality of jobs keeps many around the poverty line*

- 75 percent of poor households fail to definitely move out of poverty or vulnerability over a three-year period.
- A large number of workers are not safe and secure from poverty due to their type of job
- The quality of jobs in manufacturing is typically better – more formal and higher value
- China lifted 680 million people between 1992 and 2012 by focusing on manufacturing growth

**Status in 2010 of households who were poor in 2008 (percent)**

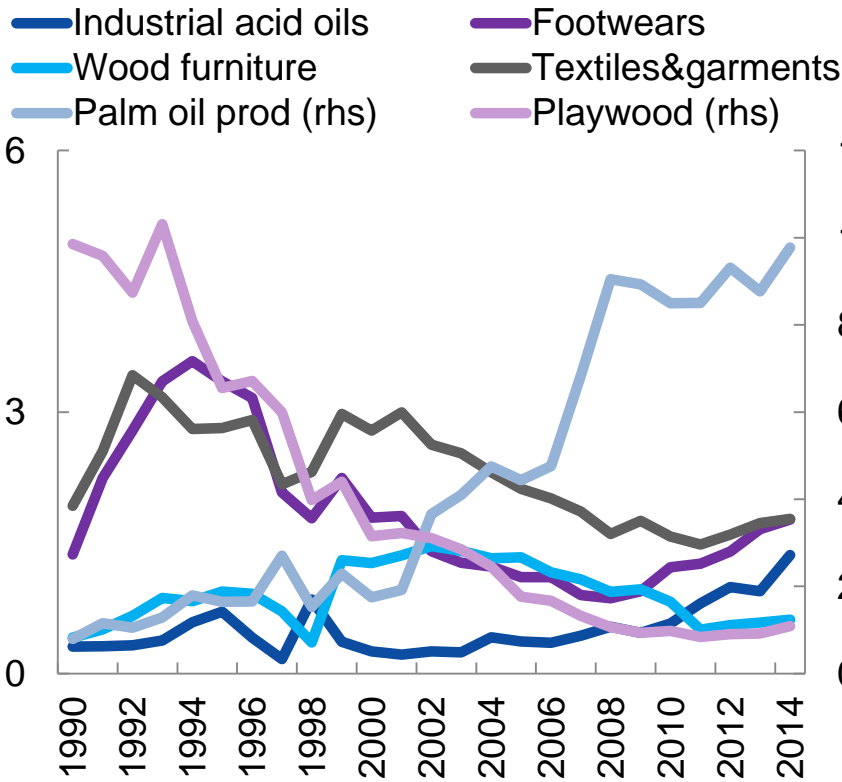


# Medium-term strategy: Identify promising industries (1)

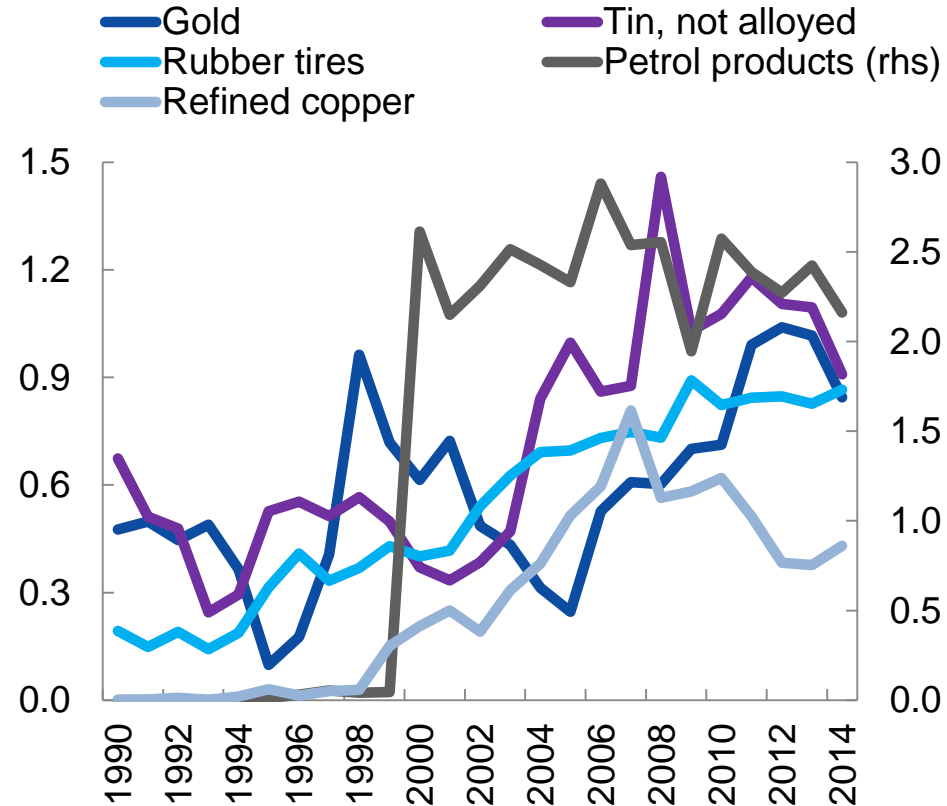
Identify promising industries, "to avoid shooting in the dark"

Share to total exports, percent

Low-tech exports



Medium-Low-tech exports



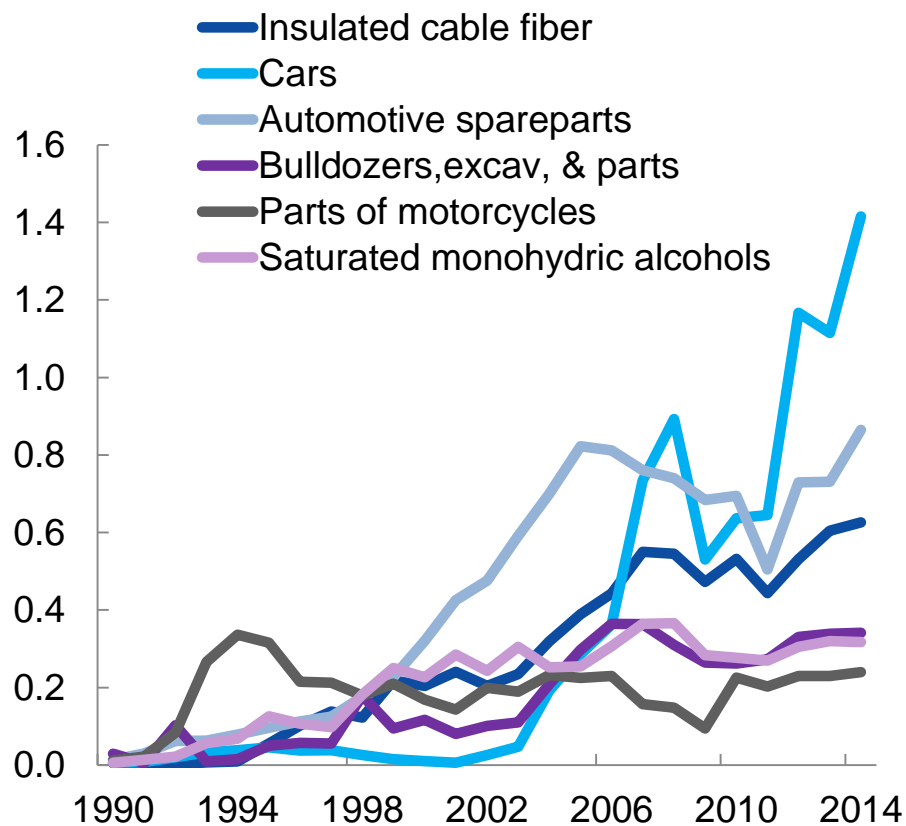
Source: UN-COMTRADE, HS4 digits and OECD industrial code

# Medium-term strategy:

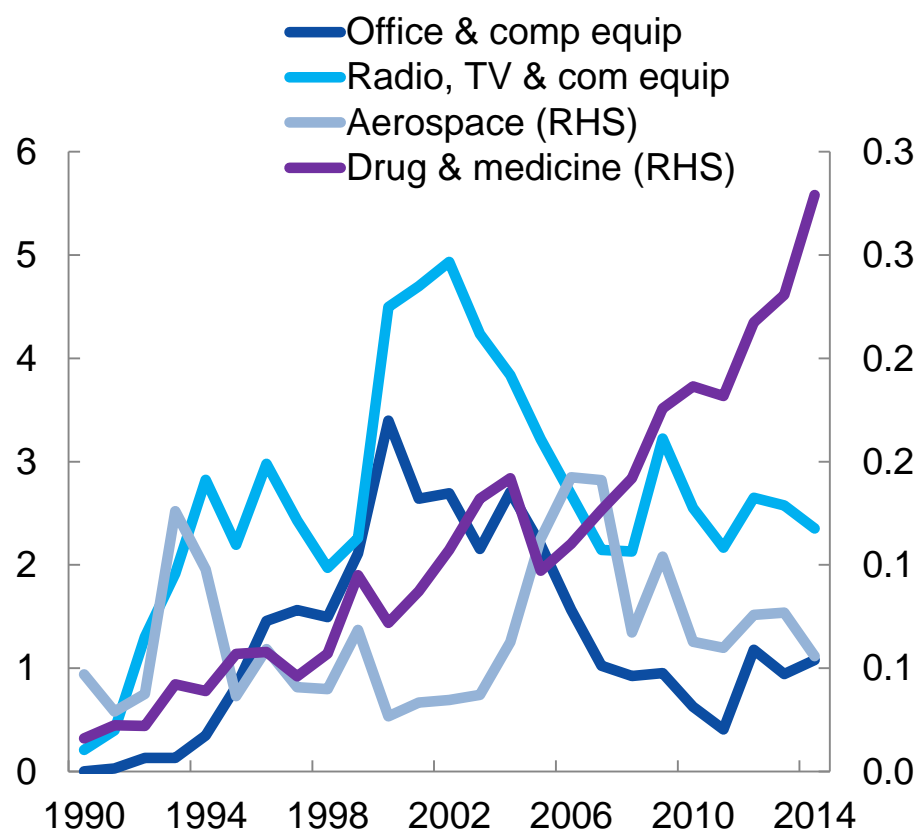
## Identify promising industries (2)

Share to total exports, percent

### Medium-high-tech exports



### High-tech exports



# Medium-term strategy:

## *Key reforms*

- Implement cross-cutting reforms to create an **supportive policy environment** for **all firms in all sectors**
- Progress on **labor laws and regulations dialogue and reform** crucial (e.g. severance pay creating a lose-lose outcome)
- Recognize that export growth and industrialization will be driven by a few industries: **policy focus** and **attention to most promising branches is key**
- For promising sectors:
  - Facilitate agglomeration/ clustering
  - Actively weed out entry barriers
  - Actively attract FDI and joint ventures in these industries
  - Public-private partnerships to close skills gaps (training, specific schools, etc.)



# Also in the March 2016 *IEQ*

## Beyond the 10 economic policy packages

- How to address constraints to growth in logistics, trade, investment climate and financial markets

## Sustainable energy development

- Aligning pricing, regulations and investment policies can help Indonesia's transition to a more sustainable energy path

## Public support for action on inequality

- A majority of Indonesians think that inequality is too high and urge government action to reduce it

